

JUN - 6 2000

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

NO PROTEST RECEIVED  
Release Copies to District

Date [REDACTED]

Signature [REDACTED]

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

Fax: [REDACTED]

[REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption under section 501(c)(15) of the Internal Revenue Code.

The information submitted indicates that you were formed on [REDACTED] under the provisions of [REDACTED]. Your sole activity is to reinsure vehicle service contracts ceded to you under your reinsurance agreement with [REDACTED].

The vehicle service contracts are service agreements to repair new and used vehicles beyond the vehicle manufacturer's warranty for a co-pay selection of either \$[REDACTED], \$[REDACTED] or \$[REDACTED] per each repair visit. Under the terms of the extended service agreement, the owner must deliver the vehicle to the selling dealer for repair. If the vehicle is more than 40 miles from the selling dealer, the owner must call one of the toll-free telephone numbers listed in the agreement for repair authorization on behalf of the selling dealer.

The vehicle service contracts are marketed by [REDACTED], [REDACTED], and [REDACTED] (the Auto Dealerships). The Auto Dealerships are wholly-owned by the [REDACTED] (the Trust). The Trust was created to distribute income to the settlor during his lifetime and to his living children upon his death. The settlor and trustee of the Trust is [REDACTED]. [REDACTED] is your sole shareholder.

Section 501(c)(15) of the Code provides for recognition of exemption of insurance companies or associations other than life (including interinsurers and reciprocal underwriters) if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000.

The principal test for what constitutes "insurance" for federal income tax purposes is set out in Helvering v. Le Gierse, 312 U.S. 531 (1941). In that case, the Supreme Court stated that "[h]istorically and commonly, insurance involves risk-shifting and risk-distributing." Id. at 539. Further, the Court stated this risk must be an "insurance risk" as opposed to an "investment risk." Id. at 542. In Allied Fidelity Corp. v. Commissioner, 66 T.C. 1068, 1074 (1976), aff'd, 572 F.2d 1190 (7th Cir. 1978), the Tax Court wrote that this risk is a risk of "a direct or indirect economic loss arising from a defined contingency," so that an "essential feature of insurance is the assumption of another's risk of economic loss."

Rev. Rul. 77-316, 1977-2 C.B. 53, addressed three situations in which a domestic corporation and its domestic subsidiaries paid amounts, designated as insurance premiums, directly or indirectly to the parent's wholly-owned "insurance" subsidiary. In Situation 1, the parent and its subsidiaries paid amounts directly to the insurance subsidiary. In Situation 2, the parent and its subsidiaries paid amounts to M, an unrelated domestic insurance company, under a contractual agreement providing that M would remain as the primary insurer but immediately "reinsure" 95 percent of the risks received with the parent's insurance subsidiary. In Situation 3, the parent and its subsidiaries paid amounts directly to the insurance subsidiary then transferred 90% of the risks to W, an unrelated insurance company. In no situation did the insurance subsidiary accept risks from parties other than the parent and its domestic subsidiaries.

Rev. Rul. 77-316 concluded that the arrangements in each of these three under which the insurance subsidiary assumed "a portion of the risks" of the parent and its domestic subsidiaries was "not insurance under the standards set forth in Le Gierse." Id. at 56.

Following Rev. Rul. 77-316, other revenue rulings placed importance on the captive insurer and the insured as being, or not being, under common control. In Rev. Rul. 78-338, 1978-2 C.B. 197, 31 unrelated shareholders owned a corporation from which they purchased insurance; no shareholder's individual risk could exceed 5% of the total risks insured by the company. The ruling stated that "[n]o shareholder own[ed] a controlling interest in the insurance company," and concluded that, "because the taxpayer and the other insureds-shareholders are not economically related," the arrangement would be treated as insurance for federal income tax purposes. In Rev. Rul. 83-172, 1983-2 C.B. 107, 40 employers formed an insurance exchange for the purpose of insuring their liability under the state workmen's compensation law. No single employer in the group provided more than 5% of the total risk insured by the

fund. The ruling found that the members of the group were not "economically related or commonly controlled." It held that the fund would be treated as an insurance company other than a life insurance company for federal income tax purposes.

Your sole business is indemnifying the risks of your owner's automobile dealerships under service contracts on which the dealerships are liable. Both you and the dealerships are economically related and commonly controlled through [REDACTED]. Your business is substantially similar to that of the company in Situation 2 of Rev. Rul. 77-316. Therefore, we find that you are not an insurance company or association other than life, and your request for recognition of exemption is denied.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224  
Attn: [REDACTED]  
T:EO:RA:T:3

  
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If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3

Form 1937-A	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
CODE						
Surname						
Date						